

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-07

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P R 141727Z MAY 76

FM USMISSION EC BRUSSELS

TO SECSTATE WASHDC PRIORITY 1169

INFO ALL EC CAPITALS 2115

C O N F I D E N T I A L SECTION 1 OF 2 EC BRUSSELS 04856

E.O. 11653: GDS

TAGS: EFIN, EEC

SUBJECT: MAY 13 EC MONETARY COMMITTEE MEETING--REVIEW OF ITALIAN
PRIOR DEPOSIT SCHEME

REF: (A) EC BRUSSELS 4733, (B) EC BRUSSELS 4530

1. SUMMARY: COMMISSION OFFICIALS TELL US THE MAY 13 MONETARY
COMMITTEE MEETING AGREED TO RECOMMEND TO EC FINANCE MINISTERS
THAT NO FURTHER EC MEDIUM TERM CREDIT SHOULD BE GRANTED TO ITALY AT
THIS TIME. ITALIAN AUTHORITIES INDICATED THAT THE PRIOR
DEPOSIT SCHEME WOULD NOT BE EXTENDED AND THE COMMITTEE
INDICATED UNDERSTANDING OF THE REASONS FOR THIS TEMPORARY,
EMERGENCY MEASURE. THE COMMITTEE CALLED FOR MORE STRINGENT
ECONOMIC POLICY CONDITIONS SHOULD ITALY EVENTUALLY BE GRANTED
FURTHER MEDIUM TERM CREDIT. END SUMMARY.

2. THE EC MONETARY COMMITTEE AT THE REQUEST OF FRANCE HELD
AN EMERGENCY MEETING ON MAY 13 TO CONSIDER THE ITALIAN 90-DAY
PRIOR DEPOSIT SCHEME. COMMISSION OFFICIALS SAY THAT
THE FRENCH REPRESENTATIVE EXPRESSED CONCERN OVER THE
RESTRICTIVE IMPACT OF THE SCHEME ON TRADE AND THE
APPROPRIATENESS OF THE COMMISSION'S DECISION TO
AUTHORIZE IT UNDER ARTICLE 108(C) OF THE TREATY. MOST
COMMITTEE MEMBERS REPORTEDLY INDICATED THAT IN VIEW
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OF THE SHARP DEPRECIATION OF THE LIRA AND THE ECONOMIC

DISLOCATION THIS WAS CAUSING IN ITALY, A SHORT TERM, EMERGENCY MEASURE WAS NECESSARY TO STABILIZE THE ECONOMY.

3. THE ITALIAN REPRESENTATIVE (PALUMBO OF THE TREASURY) ASSURED THE COMMITTEE THAT THE GOI PLANNED TO TERMINATE THE SCHEME AFTER THE 90-DAY PERIOD. THE UK REPRESENTATIVE EMPHASIZED THAT AN EXTENSION OF THE SCHEME WOULD INTENSIFY PRESSURE ON THE UK TO TAKE RESTRICTIVE MEASURES. PALUMBO SAID THAT THE GOI HOPED TO CONSOLIDATE EVENTUALLY THE PRIOR DEPOSIT SCHEME INTO A MEASURE WHICH WOULD NOT RESTRICT IMPORTS. SUCH A DECISION, HOWEVER, WOULD DEPEND ON THE NEW GOVERNMENT AND CONSEQUENTLY PALUMBO AT THIS TIME COULD ONLY SPECULATE ON WHAT SUCH A MEASURE MIGHT BE.

4. PALUMBO NOTED GLOBAL CREDIT HAD EXPANDED 5.7 TRILLION LIRE DURING THE FIRST TWO MONTHS OF 1976 COMPARED TO THE EC INTERMEDIATE TARGET OF 5.8 TRILLION FOR THE FIRST QUARTER OF THIS YEAR. PALUMBO SAID THIS EXPANSION HAD HELPED TO FINANCE THE CAPITAL FLIGHT FROM THE LIRA. THE PRIOR DEPOSIT SCHEME WOULD, HOWEVER, SHARPLY CURTAIL CREDIT IN THE SECOND QUARTER. THE COMMITTEE NOTED THAT THE GOI WOULD FACE A SHARP EXPANSION OF LIQUIDITY ONCE THE PRIOR DEPOSIT WAS REMOVED. THE GOI CONSEQUENTLY MUST TAKE OTHER MEASURES TO RESTRAIN LIQUIDITY BEFORE REMOVING THE SCHEME.

5. SEVERAL MEMBER STATES, ESPECIALLY THE FRG, FRANCE, THE NETHERLANDS AND BELGIUM, SAID THAT THE EC ECONOMIC POLICY CONDITIONS HAD NOT BEEN RESTRICTIVE ENOUGH AND HAD NOT BEEN RIGOROUSLY ENFORCED. THE COMMITTEE NOTED THAT THE IMF HAD POSTPONED A DECISION ON A STAND-BY AGREEMENT, BECAUSE IT WAS REPORTEDLY NOT CONVINCED THAT GOI BUDGETARY POLICIES WERE ADEQUATE TO MEET REQUISITE ECONOMIC POLICY TARGETS. THE COMMITTEE CALLED FOR CLOSER EC EXAMINATION OF ECONOMIC POLICIES AND THEIR LIKELY IMPACT ON MONETARY AGGREGATES.

6. COMMISSION OFFICIALS SAY THE COMMITTEE THEN TOOK UP THE POSSIBILITY OF TRANSFORMING THE SHORT-TERM CONFIDENTIAL

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CREDITS INTO MEDIUM-TERM EC LOANS. THE UK REPRESENTATIVE FEARED THAT FURTHER MEDIUM-TERM FINANCING TO ITALY COULD EXHAUST AVAILABLE EC MEDIUM-TERM FINANCIAL RESOURCES. THUS, BEFORE GRANTING FURTHER MEDIUM-TERM LOANS, THE UK ASKED THE COMMITTEE TO LOOK INTO THE ADEQUACY OF EXISTING RESOURCES. THE FRG REPRESENTATIVE ADDED THAT BEFORE ADDITIONAL RESOURCES WERE PROVIDED, THE COMMITTEE SHOULD OBTAIN ASSURANCE THAT THESE

LOANS WOULD NOT BE FRUITLESSLY SPENT ON INTERVENTIONS
IN THE EXCHANGE MARKET.

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7. ACCORDING TO COMMISSION OFFICIALS, THE COMMITTEE REACHED A CONSENSUS THAT NO FURTHER MEDIUM TERM CREDIT SHOULD BE GRANTED TO ITALY FOR THE TIME BEING. COMMISSION OFFICIALS INTERPRET THIS TO MEAN THAT THE COMMITTEE WANTED TO WAIT UNTIL AFTER THE JUNE 20-21 ELECTIONS AND UNTIL THEY COULD JUDGE THE ADEQUACY OF ANY NEW GOI ECONOMIC MEASURES BEFORE MAKING A RECOMMENDATION ON FURTHER MEDIUM TERM CREDITS. ITALIAN FINANCE MINISTER COBOMBO REPORTEDLY WAS PLANNING TO REQUEST ADDITIONAL MEDIUM TERM LOANS AT THE MAY 17 FINANCE COUNCIL. IN LIGHT OF THE COMMITTEE'S OPINION, COMMISSION OFFICIALS NOW BELIEVE THAT COLOMBO WILL PUT OFF SUCH A REQUEST.

8. CHAIRMAN POOHL SUMMED UP THE MEETING AS FOLLOWS:

1) THE COMMITTEE UNDERSTOOD THE REASONS WHY THE GOI HAD TO IMPOSE AN EMERGENCY, TEMPORARY PRIOR DEPOSIT SCHEME; 2) THE COMMITTEE WAS OF THE OPINION THAT THE SCHEME SHOULD NOT BE EXTENDED; 3) SUCH AN EXTENSION WOULD CREATE PRESSURES ON OTHER MEMBER STATES TO TAKE RESTRICTIVE TRADE MEASURES; 4) THE MONETARY COMMITTEE AND COMMISSION WOULD MAINTAIN CLOSE SURVEILLANCE OF THE PRIOR DEPOSIT SCHEME; AND 5) FOR THE TIME BEING THE COMMITTEE WAS NOT PREPARED

TO RECOMMEND TO FINANCE MINISTERS THAT THE EC SHOULD
GRANT FURTHER MEDIUM TERM CREDIT TO ITALY. POEHL SAID
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THAT SHOULD THE EC EVENTUALLY AGREE TO ADDITIONAL CREDIT,
THE CURRENT EC ECONOMIC POLICY CONDITIONS SHOULD BE MADE
MORE RIGOROUS.

9. COMMISSION FINANCE OFFICIALS ARE NOT CONCERNED THAT
THE COMMITTEE RECOMMENDATION AGAINST FURTHER EC MEDIUM
TERM ASSISTANCE AT THIS TIME MIGHT INDICATE A LACK OF EC
SOLIDARITY AND SUPPORT FOR THE CHRISTIAN DEMOCRATS. ON
THE CONTRARY, THEY POINT OUT THAT THE EC HAS ALREADY
PROVIDED SOME \$3.4 BILLION OF CREDIT TO ITALY; 1) \$1.9
BILLION UNDER THE MEDIUM TERM CREDIT FACILITY OF (OF WHICH
THE UK SHARE IS A SHORT-TERM ROLLOVER CREDIT), 2) \$1
BILLION FROM THE EC COMMON BORROWING FACILITY; AND 3)
THE \$485 MILLION JUST GRANTED FROM THE EC SHORT-
TERM CREDIT FACILITY. IN ADDITION, THEY NOTE THAT
THE FRG HAS GRANTED A GOLD COLLATERAL LOAN TO ITALY
AND THE BANK OF INTERNATIONAL SETTLEMENTS HAS JUST GRANTED
A SHORT-TERM CREDIT OF \$600 MILLION, BRINGING THE TOTAL
AMOUNT OF CREDIT FROM EUROPEAN SOURCES TO ABOUT \$5.5
BILLION.

10. COMMISSION OFFICIALS SAY THE BIS MANAGEMENT BOARD
HAS NOT YET REACHED A DECISION ON THE TERMS AND
CONDITIONS OF THE SHORT TERM CREDIT. THE BIS FIRST
IS CONSULTING ITS NON-EC SHAREHOLDERS, WHICH WILL
PROBABLY TAKE SEVERAL DAYS. THE CREDIT WOULD COME
FROM THE BIS OWN CAPITAL SO THAT BIS MEMBERS WOULD NOT BE
ASKED TO MAKE A SUBSCRIPTION. OFFICIALS HERE DO NOT
KNOW WHAT COLLATERAL, IF ANY, THE GOI WILL BE ASKED TO
PUT UP. HINTON

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